Asset management accounting matters

Management

Accounting implications for investment companies: Basic strategies for contract changes

Introduction

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

© 2017 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG Global Network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity.

This content has been developed from original work performed by the KPMG Global Network of independent member firms, and the global network of independent member firms, and is intended for use by clients of KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG Global Network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity.

Accounting implications for investment companies: Basic strategies for contract changes

Introduction

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.

Accounting implications

Any entity that settles to market or STM, the party paying interest associated with variation margin is paid to the party paying variation margin amounts.

Interest related to variation

Payment of variation margin, which generally has been treated as posted collateral, is not after the effective date of the rule changes. Consequently, the payment of variation margin is no longer a derivative liability but remains a separate receivable.

Interest related to variation

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.

Accounting implications

Any entity that settles to market or STM, the party paying interest associated with variation margin is paid to the party paying variation margin amounts.

Interest related to variation

Payment of variation margin, which generally has been treated as posted collateral, is not after the effective date of the rule changes. Consequently, the payment of variation margin is no longer a derivative liability but remains a separate receivable.

Interest related to variation

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.

Accounting implications

Any entity that settles to market or STM, the party paying interest associated with variation margin is paid to the party paying variation margin amounts.

Interest related to variation

Payment of variation margin, which generally has been treated as posted collateral, is not after the effective date of the rule changes. Consequently, the payment of variation margin is no longer a derivative liability but remains a separate receivable.

Interest related to variation

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.

Accounting implications

Any entity that settles to market or STM, the party paying interest associated with variation margin is paid to the party paying variation margin amounts.

Interest related to variation

Payment of variation margin, which generally has been treated as posted collateral, is not after the effective date of the rule changes. Consequently, the payment of variation margin is no longer a derivative liability but remains a separate receivable.

Interest related to variation

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.

Accounting implications

Any entity that settles to market or STM, the party paying interest associated with variation margin is paid to the party paying variation margin amounts.

Interest related to variation

Payment of variation margin, which generally has been treated as posted collateral, is not after the effective date of the rule changes. Consequently, the payment of variation margin is no longer a derivative liability but remains a separate receivable.

Interest related to variation

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.

Accounting implications

Any entity that settles to market or STM, the party paying interest associated with variation margin is paid to the party paying variation margin amounts.

Interest related to variation

Payment of variation margin, which generally has been treated as posted collateral, is not after the effective date of the rule changes. Consequently, the payment of variation margin is no longer a derivative liability but remains a separate receivable.

Interest related to variation

The central clearing model for derivatives is a process where a buyer and a seller agree to transact through a clearing corporation (CCP). The CCP becomes the buyer to one counterpart and the seller to the other. The CCP accepts payments of margin deposits, and when there is a default, pays the losing counterpart the difference between the market value of the contract and the amount accepted for clearing by the CCP. Payments of variation margin are treated as posted collateral in the central clearing model and the buyer and seller are no longer counterparties to each other.

Conclusions

As a result of the rule changes, the legal characterization for payments of variation margin as part of a settlement is no longer acceptable. The new rule changes appear to support the SEC view that variation margin is similar to amounts that are collateralized and the variation margin is recorded as a transfer of collateral. Although the new rule changes do not specifically address the impact on the transfer of variation margin, we believe the new rule changes are intended to align the SEC view with the industry practice of accounting for the transfer of collateral.